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James S. Keller
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December 24, 2009

Ms. Jennifer J. Johnson
Secretary
Board of Governors of the Federal Reserve System
20th Street and Constitution Avenue, NW
Washington, DC 20551

Re: Truth in Lending: Proposed Rule (Closed-End Credit)
Docket No. R-1366; 74 Fed. Reg. 43232 (August 29, 2009)

Dear Ms. Johnson:

The PNC Financial Services Group, Inc. ("PNC"), Pittsburgh, Pennsylvania, and its subsidiary bank, PNC Bank, National Association ("PNC Bank"), Wilmington, Delaware, appreciate the opportunity to comment on amendments proposed by the Board of Governors of the Federal Reserve System ("Board") to its Regulation Z (12 C.F.R. § 226)("Proposal").

PNC is one of the largest diversified financial services companies in the United States, with $271.4 billion in assets as of September 30, 2009. PNC has businesses engaged in retail banking and consumer lending, corporate and institutional banking, asset management, residential mortgage banking and global investment servicing. PNC provides many of its products and services nationally and others in PNC's primary geographic markets located in Pennsylvania, Ohio, New Jersey, Michigan, Maryland, Illinois, Indiana, Kentucky, Florida, Missouri, Virginia, Delaware, Washington, D.C., and Wisconsin. PNC also provides certain investment servicing internationally.

As a result of PNC's merger with National City Corporation in December 2008, and of PNC Bank's merger with National City Bank in November of 2009, PNC Bank is now one of the largest originators and servicers of residential mortgage loans in the country.

PNC supports the Board's efforts to simplify and streamline the form and content of the disclosures currently provided in connection with closed-end residential mortgage loans under the Truth in Lending Act ("TILA") and Regulation Z ("Regulation Z"). We are concerned, however, that, if adopted as proposed, some of these rules will have consequences that were not intended by the Board and will actually be detrimental to both borrowers and lenders alike. Thus, we offer this comment letter to identify and describe the unintended consequences of three key provisions of the Proposal.

A. Loan Originator Compensation

The Board is seeking comment on whether prohibiting loan originator compensation under proposed § 226.36(d)(1) might be unduly restrictive and unnecessary to achieve the purposes of the Proposal. We agree with the Board that borrowers should not be adversely impacted by the manner in which compensation is paid to mortgage loan originators. We also concur with the Board that borrowers should be provided with adequate information as to how fees are generated and earned by the individuals with whom those borrowers work to obtain mortgage loans. We believe that the Proposal, as written, goes beyond addressing the concerns it identifies. We are also concerned that such fundamental changes in the structure of loan originator compensation, at a time when lenders are struggling with the burdens imposed by massive regulatory change and a weak economy, could further impede financial institutions as they struggle back to profitability. As a result, it is hoped that the Board considers postponing, altering, or removing altogether the proposed prohibitions on loan originator compensation as they relate to non-brokering loan originators and their loan-originating employees.

1. The expansion of the restrictions beyond yield spread premium

The Board has proposed substantive rules restricting loan originator compensation, based largely upon perceived borrower confusion as to how mortgage brokers are compensated. In particular, the Board's research suggested that some borrowers do not always understand the relationship between yield spread premiums and other compensation paid by creditors to mortgage brokers. At the root of this confusion appears to be a belief by some borrowers that a mortgage broker owes a fiduciary duty to obtain the best rate and other loan terms from a host of different competing lenders.

As the Board set out to adopt new rules that improve the effectiveness of Regulation Z to improve a consumer's ability to make informed credit decisions, it conducted testing and heard testimony to determine where that ability may have been impeded. The results of that research did more than suggest that borrower confusion was centered on brokered transactions. "If consumers believe that brokers protect consumers' interest by shopping for the lowest rates available, the consumers will be less likely to take steps to protect their interests when dealing with brokers."[1] Nevertheless, the Board seeks to implement a compensation rule to be applied to all loan originators to protect against an "unlevel playing field" that might be created by treating employees of lenders differently than employees of mortgage brokers. However, we believe the better way to ensure that consumers as well as wholesale and retail lending markets are all treated fairly would be to apply a final compensation rule only to transactions involving a mortgage broker. Such a limitation would be a direct response to the concerns outlined in the Board's

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[1] 74 Fed. Reg. 43232,43280 (August 29, 2009).

research, and will apply irrespective of whether the entity brokering is organized as a state-licensed broker, lender, or otherwise.

2. Maintaining Flexibility in Compensation Structures

If the final rule will apply restrictions on loan originator compensation to all individuals originating loans, additional changes and clarifications should be made to balance compliance burdens with lenders' needs to recruit and retain the most talented loan originators. Since the impetus of this compensation rule is the Board's authority to prohibit unfair or deceptive acts or practices, the consequences for being found in violation could be severe. As a result, a responsible lender will have little flexibility in the way it pays loan originators for fear that variations in commission could be determined after the fact as having been the result of the terms and conditions of loans, even when they were not factored into the design of the compensation structure.

a. Single Compensation Rate

The Proposal provides two alternatives – either no terms or conditions of a loan transaction could be factored into a loan originator's compensation ("Option A") or no terms and conditions except for loan amount could serve as factors ("Option B"). We believe that Option B would be the preferable choice for the final rule. It preserves some of a lender's ability to have flexibility in its compensation structures without including compensation factors that could be seen to create incentives to "steer" borrowers. Loan amounts are driven by consumer need; they are not normally considered to be a steering issue.

If Option A were to be adopted, lenders would likely pay a single flat commission rate to loan officers for all loans, based upon the average amount of all of its loans. Such a flat commission would likely be factored back into the pricing of all loans offered by that lender. This would mean that borrowers with smaller loan amounts would pay a proportionally higher amount for loan originator compensation than borrowers with larger loans – and most likely that amount would be higher than it is today. As smaller loans tend to be obtained by borrowers with lower incomes, the impact of this pricing would be felt more by those customers than those with higher incomes. Such a result would be unfair to lower income borrowers. Option B, which would allow lenders to have flexibility based upon loan amount, would not have such an effect.

b. Geographic Markets

Significant differences exist between different geographic areas with regard to a number of factors that affect loan terms and conditions: property values, ranges of income, median incomes and other key criteria. Accordingly, the terms and conditions of loans can vary from market to market. As a result, the final rule needs to ensure that lenders will continue to have flexibility to structure loan originator compensation in a manner appropriate for a particular geographic market.

While we appreciate that the Proposal indicates the rule should not impact geographic differences in compensation, additional clarity is needed. To avoid the risk of having some form of unfair and deceptive practice claims raised against it, a lender may, in the exercise of caution, choose to set uniform compensation in all markets. Such uniform compensation might be based upon costs and returns associated with an average-size loan nationwide, in the lender's largest market, or in several of its key markets. Such inflexible compensation would cause a significant competitive disadvantage in recruiting and retaining loan officers in other markets compared to lenders who based their compensation on factors in those other markets. Equally important, because lenders would have to build the cost of compensation into loan prices for all markets, the lender would be forced to offer loans at higher prices in some markets, thereby unduly limiting borrower choice.

Accordingly, the Board is urged to expressly indicate in the text of the final rule that compensation structures based upon geographic markets are not violative of 12 C.F.R. § 226.36.

c. Sufficiency of Disclosure

In support of the scope and substance of the compensation controls, the Board states that "disclosure alone would be insufficient for most borrowers to avoid the harm caused by this practice." We believe this statement can only be tested by taking into account the impact of the recent substantive changes to other mortgage lending laws and regulations. Thus, we believe that any final rule on loan originator compensation should be adopted with appropriate regard given to the impact of these other new changes. This consideration would be appropriate because those other laws and regulations are altering the content and form of information available to borrowers such that disclosure will likely be sufficient to avoid any potential consumer harm.

Beginning January 1, 2010, HUD's Regulation X will require a significantly updated Good Faith Estimate ("GFE") that must be provided to borrowers within three days of applying for a mortgage loan. This new form requires not only disclosing all origination charges, including yield spread premiums, but also providing a numerical representation of the interrelationship between lender or broker compensation and the interest rate being offered to the borrower as well. Additionally, these origination charges are subject to a new "zero tolerance" restriction, which means they may not be increased between the time of the GFE and closing absent certain "changed circumstances" and compliance with the other substantive provisions of Regulation X.

Admittedly, the GFE will not identify the precise amount of compensation to be received by each individual and/or corporate party to the transaction. However, all of the additional upfront fees being charged or credited in connection with an offered interest rate would be clearer than today. Significantly, borrowers would be made immediately aware of the interrelationship between all origination charges and the offered interest rate. This would better allow the borrower to compare and contrast offers from different lenders, brokers, or a combination thereof.

Additionally, the Secure and Fair Enforcement for Mortgage Licensing Act ("SAFE Act") will begin to have an impact on the residential mortgage industry in 2010. As the Board is aware, the SAFE Act requires the licensing and/or registration of individual loan originators, irrespective of whether those individuals are working for banks, mortgage companies, or mortgage brokers. One of the primary purposes of the SAFE Act is to provide borrowers with pertinent information on the individuals with whom they are dealing on mortgage transactions. This transparency will allow for easy recognition of current employment information, employment history, disciplinary history and other relevant information to increase the accountability of mortgage loan officers to the borrowers they serve.

These new laws will be altering the manner in which borrowers interact with mortgage lenders, brokers, and loan originators. None of these was in place when the Board conducted its research on loan originator compensation, and we believe that before adopting sweeping changes to the manner in which loan originators are compensated the Board should permit them to have their respective intended impacts on the marketplace.

d. Additional Concerns

The Board identified various examples of the types of compensation arrangements that would not violate the proposed new rule. These compensation methods are key tools in effectively managing employees and loan pipelines. Additionally, they help lenders manage loan quality to the benefit of both borrowers and the financial health of the lending institution. At the same time, they do not have a potential negative impact on an individual borrower or transaction. Accordingly, to give clear guidance that such compensation factors are allowed, the final rule should specifically state that certain key compensation factors are deemed not to be based on individual loan terms and conditions. These factors should include:

- a loan originator's total loan volume in a set period of time;
- a loan originator's pull-through rates;
- a loan originator's file quality;
- the type of transaction (purchase versus refinance);
- any other objective, non-transaction specific formula that a lender deems appropriate for compensating its loan originators;

- a clear exemption for managers and supervisors from the definition of loan originator.

We believe that the foregoing comments and suggestions will permit the Board to adopt a final compensation rule that appropriately balances the interests of lenders, brokers and consumers.

B. Steering

We appreciate the intent of the Board's inquiring as to whether or not it should adopt a rule to curb what has become known as "steering." We agree that borrowers should not be misdirected to inappropriate loan products simply because such products might be more lucrative to the individual originating the loan. The Proposal addresses this issue by requiring that steering be measured by whether or not a loan was in a borrower's interest. Unfortunately, such a standard creates inherent uncertainty for lenders and borrowers and could well lead to a flood of meritless litigation. Unless "borrower's interest" is defined by a standard that can be objectively measured at the time of loan origination, the lender will always be subject to "second guessing" – subjective hindsight of long passed market conditions, available loan types and terms, and borrower desires and needs.

It is our belief that the other rules contained within the Proposal impacting the content and form of disclosures, as well as recent updates to Regulation X, the SAFE Act, and the Mortgage Disclosure Improvement Act, will operate together to inform borrowers fully and appropriately and protect them from being inappropriately steered. In fact, as a result of these other changes to law that existed at the time the Proposal was issued, borrowers will receive much more information earlier in the borrowing process, which will, in turn, encourage comparing and contrasting various loan options among several lenders and/or brokers. In our view, the protections offered by sharing potential product options with borrowers is far superior to a wholly subjective "borrower's interest" standard.

C. Definition of Finance Charge

The Proposal alters the manner in which the finance charge is defined by Congress in the TILA for closed-end extensions of credit secured by an interest in real property. Importantly, the result of these changes will be to include as finance charges essentially *all* origination fees, irrespective of whether they are charged by the lender, an affiliate, an unaffiliated third party vendor or the government, including those currently excluded by 15 U.S.C. § 1605(e). The Board is seeking comment on the cost, burden and benefits to borrowers and to industry that would result from changing TILA's definition of the finance charge for closed-end mortgage transactions.

We support the Proposal's intent to make the cost of credit more easily understandable to borrowers. We also applaud the Board's efforts to streamline and simplify the manner in which the finance charge is determined and the APR computed. While the concept of an all inclusive finance charge calculated in the same way by all creditors appears, on its face, to be a neutral change with no adverse impacts, we are concerned with one unintended consequence that will ultimately make credit less available without a corresponding benefit to borrowers: the impact on high cost and higher priced mortgage loans, as discussed below. Based on this consequence, therefore, we do not believe that the Proposal's changes to the finance charge should be adopted in the final rule. Because of this detrimental impact, and because the cost of credit will be more robustly disclosed through related disclosure changes, we recommend that the Board not change the definition of finance charge.

1. *High Cost and Higher Priced Mortgage Loans*

This proposed expansion of the definition of "finance charge" will directly impact the number of loans subject to either high cost or higher priced (also known as "rate spread") mortgage loan laws under both state and federal law. As the Board recognizes, adding fees to the finance charge will cause annual percentage rates to increase. This will cause more loans to exceed high cost or higher priced thresholds. Most states incorporate some or all of the federal definitions of finance charge, APR or points and fees in their high cost loan or higher priced loan laws and regulations. Altering the definition of "finance charge" under TILA and Regulation Z will increase the number of loans subject to high cost or higher priced mortgage loan laws to include loans that are not truly "high cost" in any reasonable meaning of the term.

As the Board knows through its own Home Mortgage Disclosure Act studies, most lenders do not make federal or state high cost loans due to the reputation, legal and compliance risks associated with them. Further, most investors and secondary market agencies will not purchase such loans. The result has been a dramatic decrease in the volume of these loans so that they are only originated at a fraction of the level at which they were available historically. It may be that many lenders and investors will also shy away from making higher priced or rate spread loans for the same reasons.

2. *The New Disclosures*

The primary consideration behind the expanded definition of "finance charge" was for consumers to be given the opportunity to understand the entire "cost" associated with obtaining a mortgage loan. The recent changes to Regulation X, as well as the updates to disclosure requirements provided in the Proposal, will accomplish this goal without the corresponding impact on high cost or higher priced mortgage loan laws.

For example, under the January 1, 2010 changes to Regulation X, borrowers will receive a much greater level of detail as to the costs of settlement. As mentioned in Section A above, the new GFE will permit borrowers to compare and contrast the terms and conditions of loan offers from various lenders. Not only will this new GFE set forth all costs that will be incurred by a borrower in connection with a residential mortgage transaction, it will make it significantly more difficult for those fees to change between the time of application and the closing of the loan. This disclosure, which must be provided within three days of an application, will have fees grouped together based upon their purpose and whether the borrower or creditor selected the service provider. This will permit borrowers to see the true cost of credit in a proposed loan transaction and to compare those costs to any other loan offers he or she has received, which was the primary goal behind the proposed changes to "finance charge."

Because of the effects of the proposed changes to the definition of finance charge on state high cost and higher priced loan laws, and the beneficial effects of the new disclosures discussed immediately above, we recommend that the definition of finance charge not be changed.

D. Conclusion

Thank you very much for the opportunity to comment on the proposed regulations. If you would like to discuss any aspect of this letter, please do not hesitate to contact me.

Sincerely,

James S. Keller

cc: Michael D. Coldwell
Federal Reserve Bank of Cleveland